1999 Country Reports on Economic Policy and Trade Practices
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CZECH REPUBLIC

Key Economic Indicators

(Millions of U.S. Dollars unless otherwise indicated)

	1997	1998	1999 1/
Income, Production and Employment:			
Nominal GDP (US$ billion) 2/	53.0	56.4	54.0
Real GDP Growth (pct)	0.3	-2.3	-0.5
GDP by Sector (pct): 2/			
Agriculture	4.6	5.1	5.3
Manufacturing	26.6	31.4	31.2
Services	51.4	51.9	52.1
Government 3/	31.8	31.2	31.9
Per Capita GDP (US$) 2/	5,144	5,483	5,196
Labor Force (000s)	5,000	5,170	5,203
Unemployment (pct)	5.2	7.5	10.0
Money and Prices (annual percentage growth):			
Money Supply Growth (M2)	10.1	5.2	7.8
Consumer Price Inflation	8.5	10.7	2.2
Exchange Rate (CKR/US$)			
Official	31.71	32.27	34.40
Balance of Payments and Trade: 4/			
Total Exports FOB (USD bill)	22.8	26.3	27.4
Exports to U.S.	586	441	650
Total imports CIF (USD bill)	27.2	28.8	29.2
Imports from U.S.	1,029	786	1,180
Trade Balance (USD bill)	-4.4	-2.5	-1.8
Balance with U.S.	-442	-345	-530
Current Account Deficit/GDP (pct)	-6.1	-1.9	-1.5
External Debt 5/	21.6	24.3	24.3
Debt Service Payments/GDP (pct)	10.0	10.0	7.5
Fiscal Deficit (Central)/GDP (pct)	0.9	1.6	2.1
Gold and Foreign Exchange Reserves	15.0	15.9	13.2
Aid from U.S. 6/	6.0	N/A	N/A
Aid from All Other Sources	N/A	N/A	N/A

1/ Unless stated otherwise, 1999 figures are based on the latest estimates of the Czech Statistical Office (CSO) dated October 4, 1999, of the Ministry of Finance and/or unofficial estimates from the Czech National Bank.

2/ GDP at factor cost, percentage changes calculated in local currency.

3/ Central government spending as pct of GDP.

4/ Czech imports do not include re-exports of U.S. goods through other countries.

5/ In absolute numbers, the figure for external debt does not change, the growth reflects shifts in DEM vs. US$ exchange rates.

6/ U.S. assistance was phased out by September 30, 1997.

1. General Policy Framework

The Czech Republic is a small and generally open economy. Having largely created a free and competitive market, it is currently struggling with problems stemming from unfinished structural reforms mainly in the field of bank privatization, industrial restructuring, legal reform and improvements of financial markets transparency. Unfinished structural reforms lie at the heart of the Czech Republic's current severe recession, which led to an economic contraction of 2.3 percent in 1998.

Till 1998, the Czech Republic pursued balanced budgets, incurring only small deficits on the way. Budget deficits incurred have traditionally been financed through the issuance of government bonds. Economic recession, failure to collect taxes satisfactorily and the Social Democratic government's pledge to support a wide range of social welfare and investment programs led to the 1999 planned budget deficit of approximately 1.6 percent of then estimated GDP. The government now anticipates the final deficit will be larger and the 2000 budget, currently under discussion, will also be in deficit.

In 1998 the Czech government approved a package of incentives to attract investments. The incentives are offered to foreign and domestic firms that make a $10 million manufacturing investment through a newly registered company. The package includes tax breaks of up to 10 years offered in two five-year periods; duty-free imports of high-tech equipment and a 90-day deferral of value-added tax payments (VAT); potential for creation of special customs zones; job creation benefits; training grants; opportunities to obtain low-cost land; and the possibility of additional incentives for secondary investments and production expansion.

Czech National Bank is by law responsible for monetary policy. The primary instrument used by the bank to influence monetary policy is the two-week repo rate. Following sharp and growing current account imbalances in the spring of 1997, the central bank implemented a series of austerity measures designed to dampen inflation and reduce external imbalances. Monetary policy during most of 1998 remained restrictive, with maintenance of relatively high interest rates designed to reduce inflation and dampen domestic demand and high compulsory bank reserves to lower the amount of money in the economy. In 1999, with the current account well on the way to recovery and the relatively still strong exchange rate of the crown, the central bank, ahead of its inflation target for a second year in row, cut interest rates several times.

The Czech Republic enjoyed a strong inflow of foreign direct investment ($1.3 billion) and portfolio investments ($3.9 billion) to June 30, 1999. Though much needed for the economy and recognized as such by the government, the central bank has expressed concern that the strong inflows are pushing up the exchange rate and hurting overall economic competitiveness. They are currently exploring measures to neutralize the impact of these flows.

2. Exchange Rate Policy

The Czech crown is fully convertible for most business transactions. The Foreign Exchange Act provides a legislative framework for full current account convertibility, including all trade transactions and most investment transactions, pending government action on implementing regulations. As of January 1999 all capital account restrictions were removed except for the ability of Czechs to open bank accounts abroad without a permit by the central bank, and the purchase of real estate in the Czech Republic by foreigners. The permit requirement will lapse in 2000, and foreign company branches will be able to acquire real estate as of 2002, in accordance with the Czech Republic's commitments in the Organization for Economic Cooperation and Development (OECD).

The Czech crown, floating freely since the spring of 1997, has remained relatively steady, withstanding 1998's Russian financial turmoil. Having appreciated in value due to high interest rate differentials between the Czech Republic and its major trading partners, it has remained strong even after the central bank reduced the interest rates significantly in 1998 and 1999, as currency traders bet on EU convergence.

3. Structural Policies

The government sees full membership in the European Union (EU) as one of its highest foreign policy priorities. Relations between the Czech Republic and the EU are currently governed by an EU association agreement signed in 1991. The start of detailed accession negotiations began in November 1998. Most observers do not anticipate that full EU membership will be achieved prior to 2003. As part of the EU accession process, many of the Czech Republic's regulatory policies and practices are slowly evolving toward EU norms. Through membership in OECD, the Czech Republic agreed to meet, with relatively few exceptions, OECD standards for equal treatment of foreign and domestic investors and restrictions on special investment incentives. The United States has succeeded in using the OECD membership process to encourage the Czech Republic to make several improvements to the business climate for U.S. firms.

Czech tax codes are generally in line with European Union tax policies. In 1998, the government reduced taxes on corporate profits to 35 percent from 38 percent. The tax rate for the highest tax bracket for personal income tax stands at 40 percent. Employer and employees social insurance contributions are respectively 35 percent and 12.5 percent. The government permits tax write-offs of bad debts, although with less generous treatment of pre-1995 debts. Firms are allowed to write-off the first year's share of a bad debt without filing suit against the debtor, though subsequent write-offs must document unsuccessful efforts to collect past due amounts. U.S. firms have complained that Czech tax legislation effectively penalizes use of holding company structures by leveling both corporate tax and dividends withholding tax on profit flows between group companies, thus creating double taxation on such profits. Czech law does not permit intra-group use of losses (i.e., offsetting losses in one group entity against profits in another), and imposes corporate tax on dividends received from foreign holding without allowing use of a foreign tax credit for the underlying tax suffered in the subsidiary's home jurisdiction.

Stricter bankruptcy provisions, an important part of the government's structural reforms came into effect in April 1998, but the focus is still on liquidation rather than reorganization. Most observers believe the slow and uneven courts, and close links between banks and firms, limit the effectiveness of the measure. Members of Parliament and others have called for a bankruptcy law closer to the U.S. Chapter Eleven provision to encourage resuscitation of troubled firms. There is a three to four year backlog in the bankruptcy courts and a small secondary market for the liquidation of seized assets. Recognizing that the lack of economic restructuring caused by inadequate bankruptcy laws hampers potential economic growth, the government is preparing another large amendment of the bankruptcy law for 2000. .

4. Debt Management Policies

The Czech Republic maintains a moderate foreign debt and has received investment grade ratings from the major international credit agencies. In 1998 gross foreign debt measured $24.3 billion and is not expected to change much in 1999. To June 30, 1999 gross foreign debt measured $22.4 billion, most of the amount being the debt of companies ($11.3 billion) and commercial banks ($9.8 billion). Debt service as a percentage of GDP and debt service to exports stand at 7.5 percent and 13.5 percent, respectively. The Czech Republic repaid its entire debt with the International Monetary Fund (IMF) ahead of schedule. Under the Paris Club, the Czech Republic, as member of OECD, rescheduled its official credits to Russia.

5. Aid

The Czech Republic graduated from U.S. AID assistance on September 30, 1997. In 1998, however, U.S. AID offered the country its program of Partners for Financial Stability and in 1999 two projects were launched. The Czech Republic continues to receive assistance from the European Union's PHARE program and individual EU member states to assist its transformation during the accession period for EU membership. According to the European Commission Delegation in Prague, since 1990 the Czech Republic has received 580 million ECU in PHARE assistance.

6. Significant Barriers to U.S. Exports

The Czech Republic is committed to a free market and maintains a generally open economy with few barriers to trade and investment. It is a member of the World Trade Organization (WTO), and has adopted a WTO tariff code with a trade-weighted average tariff of 4.8 percent. This is being reduced gradually to 3.5 percent in accordance with Czech commitments in the Uruguay Round of trade negotiations. The Czech Republic is not a signatory to the General Agreement on Tariffs and Trade (GATT) civil aircraft code, but is a member of the WTO's Information Technology Agreement.

The Czech Republic's EU association agreement established preferential tariffs for non-agricultural, EU-origin products to the Czech markets, while maintaining higher most-favored-nation rates for U.S. and other non-EU products. The preferential tariffs for EU goods are declining on an annual basis and by 2001 most EU industrial products will enjoy duty-free status. Since 1992, when the trade-related provisions of the EU association agreement first came into force, a number of U.S. companies within many industry sectors have complained that tariff preferences given the EU under the agreement have diminished their business prospects and ability to compete against EU-origin products.

Trade in agricultural/food products is generally free of major trade barriers although technical barriers continue to hamper imports of certain products. In anticipation of EU membership, the Czech Republic is rewriting much of its legislation related to standards and trade in agricultural/food products. During this transition phase, it is not always clear which rules apply, a situation which has led to some delays in approval. The harmonization of standards with the EU should ease the paperwork burden for those exporters already exporting to the EU. However, the alignment of Czech food legislation with the EU also means that certain products currently prohibited in the EU will also be prohibited in the Czech Republic in the future.

The government is in the process of drafting legislation in line with EU directives to regulate Genetically Modified Organisms (GMOs). A final bill is expected in 2000. The Czech Republic continues to approve new GMO varieties for field testing.

U.S. exporters of beef, poultry, pork and horse meat are not yet able to ship to the Czech Republic due to problems with export certification. USDA's Food Safety Inspection Service (FSIS) is currently reviewing certification documents proposed by the Czech State veterinary Administration.

American business people often cite a convoluted, or in some cases corrupt, bureaucratic system, both at national and local levels, which can act as an impediment to market access. Often considerable time is spent by a potential investor to finalize a deal, or enforce the terms of a contract. European companies have sought on occasion to use the Czech Republic's interest in EU membership to gain advantage in commercial competition.

The government is required by law to hold tenders for major procurement. The law, introduced in 1994, proved unsatisfactory. Several revisions aimed at making the law simpler and transparent failed. Recognizing that no amendment will help, the Czech Republic is currently working on a brand new procurement law to enter force in 2001. Fully harmonized with EU legislation, it will remove also the current ten percent price advantage for domestic firms. The Czech Republic is not a member of the WTO Government Procurement Agreement.

The Czech Ministry of Industry and Trade issues import licenses to those seeking to import selected goods into the Czech Republic. While most products and services are exempt from licensing, oil, natural gas, pyrotechnical products, sporting guns and ammunition require an import license.

Legally, foreign and domestic investors are treated identically and both are subject to the same tax codes and other laws. The government does not screen foreign investment projects other than for a few sensitive industries, e.g., in the defense sector. The government evaluates all investment offers for the few state enterprises still undergoing privatization. As part of OECD membership, the Czech Republic committed not to discriminate against foreign investors in privatization sales, with only a few excepted sectors. The government has overcome political resistance to foreign investment in certain sensitive sectors, such as petrochemical, telecommunications and breweries. The ban on foreign ownership of real estate remains another important exception, although foreign-owned Czech firms may purchase real estate freely.

U.S. investors interested in starting joint ventures with or acquiring Czech firms have experienced problems with unclear ownership and lack of information on company finances. Investors have complained about the difficulty of protecting their rights through legal means such as a secured interest. In particular, investors have been frustrated by the lack of effective recourse to the court system. The slow pace of court procedures is often compounded by judges' limited understanding of complex commercial cases. Also the Czech Republic imposes a Czech language requirement for trade licenses for most forms of business. This requirement can be fulfilled by a Czech partner, but this can be burdensome and involves additional risks.

The opaque nature of the stock market puts U.S. investors and financial services providers at a competitive disadvantage. While stock market reforms were enacted in 1996 to help protect small shareholders and increase transparency of transactions, enforcement has been uneven. A Czech Securities Commission opened in 1998 with a mission of improving the regulatory framework of the capital market, increasing capital market transparency, and restoring investor confidence. To the date, the Commission issued some 2,300 authorized rulings, and in the re-licensing process revoked 663 licenses. It has, however, been hampered by budgetary constraints and a lack of rule-making authority.

U.S. firms also complain about the lack of consistency in the application of customs norms. These problems are primarily due to the newness of recent regulatory changes and rapid expansion of customs personnel. Training efforts are underway to correct the situation and address these concerns.

7. Export Subsidies Policy

The Czech Export Bank provides export guarantees and credits to Czech exporters. The bank follows OECD consensus on export credits. Additionally, the government maintains a fund through which it purchases domestic agricultural surpluses for resale on international markets. For some commodities, pricing is established at a level that includes a subsidy to local producers.

8. Protection of U.S. Intellectual Property

The Czech Republic is a member of the Berne and Universal Copyright Conventions and the Paris Convention on Industrial Property. Czech laws for the protection of intellectual property rights (IPR) are generally good, but enforcement has lagged. Existing legislation guarantees protection of all forms of property rights, including patents, copyrights, trademarks and semiconductor chip layout design. The Czechs continue to harmonize with the Trade Related Aspects of Intellectual Property Rights (TRIPS) agreement and parliamentary approval is expected on an amendment providing 70 years of copyright protection for literary works, up from the present 50 years. It is likely that the Czech Republic will not meet the January 2000 deadline to implement all of its TRIPs-related obligations, but legislation is pending in Parliament which should address most or all of its commitments in this area.

As a result of enforcement weaknesses and delays in indictments and prosecutions, the U.S. Government placed the Czech Republic on the Watch List during the 1999 Special 301 cycle. The Embassy continues to work with U.S. industry and Czech government officials to improve enforcement of IPR norms. There are also two legislative amendments, which will expand tools of enforcement of IPR. One, approved to enter force as of December 1, 1999, boosts the powers of the customs service to seize counterfeit goods, and the other, albeit still in drafting stages, would allow the Czech Commercial Inspection (CCI) to act directly in IPR cases. At present, the CCI can only act in conjunction with the police.

9. Worker Rights

a. The Right of Association: The law provides workers with the right to form and join unions of their own choice without prior authorization, and the government respects this right in practice. Most workers are members of unions affiliated with the Czech-Moravian Chamber of Trade Unions (CMKOS), a democratically oriented, republic-wide umbrella organization for branch unions. The unions are not affiliated with political parties and exercise independence. Workers have the right to strike, except for those whose role in public order or public safety is deemed crucial. By law, strikes may take place only after mediation efforts fail. Unions are free to form or join federations and confederations and affiliate with and participate in international bodies. Union membership is on the decline.

b. The Right to Organize and Bargain Collectively: The law provides for collective bargaining, which is generally carried out by unions and employers on a company basis. The scope for collective bargaining is more limited in the government sector, where wages depend on the budget.

c. Prohibition of Forced or Compulsory Labor: The law prohibits forced or compulsory labor, including that performed by children, and it is not practiced.

d. Minimum Age for Employment of Children: The Labor Code stipulates a minimum working age of 15 years, although children who have completed courses at special schools (schools for the mentally disabled and socially maladjusted) may work at age 14. These prohibitions are enforced in practice.

e. Acceptable Conditions of Work: The government sets minimum wage standards. The minimum wage is 3,600 Czech Crowns per month (approximately $100), although the monthly average is 12,766 Czech Crowns (approximately $365) per month. Average net wages are 2.1 times as high as official sustenance costs. The minimum wage provides a sparse standard of living for an individual worker or family, although allowances are available to families with children. The law mandates a standard workweek of 42 1/2 hours. It also requires paid rest of at least 30 minutes during the standard 8 to 8 1/2-hour workday, as well as annual leave from three or four weeks up to eight weeks depending on the profession. Overtime ordered by the employer may not exceed 150 hours per year or 8 hours per week as a standard practice. Industrial accident rates are not unusually high. Workers have the right to refuse work endangering their life or health without risk of loss of employment.

f. Rights in Sectors with U.S. Investment: All of the above observations on worker rights apply to firms with foreign investment. Rights in these sectors do not differ from those in other sectors of the economy. Conditions in sectors with U.S. investment do not differ from those outlined above.

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad on an Historical Cost Basis **--** 1998

(Millions of U.S. Dollars)

Category		Amount
Petroleum		(1)
Total Manufacturing		170
Food & Kindred Products	10	
Chemicals & Allied Products	58	
Primary & Fabricated Metals	6	
Industrial Machinery and Equipment	30	
Electric & Electronic Equipment	-31	
Transportation Equipment	23	
Other Manufacturing	74	
Wholesale Trade		68
Banking		(1)
Finance/Insurance/Real Estate		60
Services		30
Other Industries		38
TOTAL ALL INDUSTRIES		543

(1) Suppressed to avoid disclosing data of individual companies.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.